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No. 73-197

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

ROBERT R. FRANK, JACK H. STEIN, JOHN W. ROBERTS, JR., individually and as purported trustees under a Voting Trust Agreement dated June 2, 1969, relating to the issued shares of INDUSTRIAL GUARANTY BANCORP, a Florida corporation, and INDUSTRIAL GUARANTY BANCORP, a Florida corporation,

Petitioners,

vs.

J. WILLIAM WOLF and PEARL M. WOLF, individually and derivatively for the shareholders of INDUSTRIAL GUARANTY BANCORP, a Florida corporation,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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INDEX

	Page
CITATION TO OPINIONS BELOW	2
JURISDICTION	2
QUESTIONS PRESENTED	3
STATUTES, FEDERAL RULES OF CIVIL PROCEDURE AND ADMINISTRATIVE REGULATIONS INVOLVED	6
STATEMENT	
A. PROCEEDINGS IN THE TRIAL COURT	14
B. PROCEEDINGS IN THE COURT OF APPEALS	21
REASONS FOR GRANTING THE WRIT	22
CONCLUSION	35

INDEX OF AUTHORITIES

	Page
Armstrong Paint & Varnish Co. v. Nu-Enamel Corp., 305 U.S. 315, 59 S.Ct. 191, 83 L.Ed. 195, rehearing denied 305 U.S. 675, 59 S.Ct. 356, 83 L.Ed. 437 (1938)	24
Crane Co. v. Westinghouse Air Brake Co. (CA2 1969) 419 F.2d 787, 793	28
Deckert v. Independence Shares Corp., 311 U.S. 282, 287-288 (1940)	30
DePova v. Camden Forge Co., (CA3 1958) 254 F.2d 248	25
Earle R. Hanson & Assoc. v. Farmers Coop. Creamery Co. (CA8 1968) 403 F.2d 65, 70	29
Feist v. Young (CA7 1943) 138 F.2d 972	29
Gaudiosi v. Mellon (CA3 1959) 269 F.2d 873, 882	28
Herpich v. Wallace (CA5 1970) 430 F.2d 792, 804	32
Hurn v. Oursler, 289 U.S. 238, 53 S.Ct. 586, 589, 77 L.Ed. 1148 (1933)	24

INDEX OF AUTHORITIES
(Continued)

Page

J. I. Case v. Borak,
377 U.S. 426, 433, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964) 27

Katz v. Amos Treat Co.
(CA2 1969) 411 F.2d 1046, 1054 30

Keystone Driller Co. v. General Excavator Co.,
290 U.S. 240, 54 S.Ct. 146, 78 L.Ed. 293 (1933) 26, 28

Knauff v. Utah Construction & Mining Co.
(CA10 1969) 408 F.2d 958 25

Kuehnert v. Texstar Corporation,
(CA5 1969) 412 F.2d 700 29

Lanning v. Sherwood
(CA9 1973) 474 F.2d 716, 719 25

Monsanto Co. v. Rohm & Haas Co.
(CA3 1972) 456 F.2d 592 28

Morton Salt Co. v. G. S. Suppiger Co.
314 U.S. 488, 62 S.Ct. 402, 86 L.Ed. 363 (1942) 26, 28

Mott v. Tri-Continental Financial Corp.
(CA2 1964) 330 F.2d 468, 471 30

Nolen v. Shaw-Walker Co.
(CA6 1971) 449 F.2d 506, 508 30

INDEX OF AUTHORITIES
(Continued)

	Page
Pearlstein v. Scudder and German (CA2 1970) 420 F.2d 1136, 1141	27
Perma Life Mufflers v. Intern. Parts Corp. 392 U.S. 134, 88 S.Ct. 1981, 20 L.Ed.2d 982 (1968)	27
Popkin v. Bishop (CA2 1972) 464 F.2d 714	25
Precision Instrument Mfg. Co. v. Automotive Maintenance Mach. Co., 324 U.S. 806, 65 S.Ct. 993, 89 L.Ed. 1381 (1945)	26
Reading Co. v. Koons, 271 U.S. 58, 46 S.Ct. 405, 406, 70 L.Ed. 835 (1936)	32
Republic Molding v. B. W. Photo Utilities (CA9 1963) 319 F.2d 347, 350	29
Rumbaugh v. Winifrede Railroad Co. (CA4 1964) 331 F.2d 530, cert. denied 379 U.S. 923, 85 S.Ct. 322, 13 L.Ed.2d 341 (1964)	24
SEC v. Texas Gulf Sulphur (CA2 1968) 401 F.2d 833, 858, 860, cert. denied sub nom, Coates v. SEC, 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed.2d 756 (1969)	28

INDEX OF AUTHORITIES
(Continued)

Page

Serzysko v. Chase Manhattan Bank
(CA2 1969) 409 F.2d 1360, affirming Serzysko v. Chase Manhattan Bank (SDNY 1968) 290 F.Supp. 74 28

Straley v. Universal Uranium and Milling Corp.
(CA9 1961) 289 F.2d 370, 373 30

Superintendent of Insurance v. Bankers Life & Casualty,
404 U.S. 6, 12, 92 S.Ct. 165, 30 L.Ed.2d 128 (1971) 25

Texas Continental Life Ins. v. Dunne
(CA6 1962) 307 F.2d 249 34

United Mine Workers v. Gibbs,
383 U.S. 715, 725, 727, 86 S.Ct. 1130, 16 L.Ed.2d 218 (1966) 26

United States v. United States Gypsum Co.,
333 U.S. 364, 395, 68 S.Ct. 525, 92 L.Ed. 746 (1948) 33

West Los Angeles Institute for Cancer Research v. Mayer
(CA9 1966) 366 F.2d 220, 227 29

Wolf v. Frank
(CA5 1973) 477 F.2d 467 ..... 2, 21

INDEX OF AUTHORITIES
(Continued)

	Page
Zahn v. Transamerica Corporation (CA3 1947) 162 F.2d 106	24
Securities Act of 1933	
15 U.S.C. §§ 77a thru 77aa	3
15 U.S.C. § 77e	6, 17
15 U.S.C. § 77 1	5, 8, 31
Securities Exchange Act of 1934	
15 U.S.C. §§ 78a thru 78hh	3
15 U.S.C. § 78j(b)	9, 17
15 U.S.C. § 78bb	5, 9, 31
28 U.S.C. § 1254(1)	2
28 U.S.C. § 1652	5, 10
Federal Rules of Civil Procedure, 28 U.S.C.	
Rule 23.1	4, 11
Rule 82	12
12 CFR § 221.4	
Regulation U, Federal Reserve System	12, 16, 26

INDEX OF AUTHORITIES
(Continued)

	Page
17 CFR § 240.10b-5 SEC Rule 10b-5	3, 12
5 ALR3d 1060-1062	25
3 Loss, Security Regulation 1424 (¶nd Ed. 1961)	33
5 Fletcher Cyc.Corp § 2143.1 (Perm.Ed. 1967)	25
3B Moore's Federal Practice, ¶ 2.1.16, pp. 23.1-101 thru 106	25
8 SEC Ann.Rep. 10 (1943)	33
Hearings on Stock Exchange Regulations before the House Committee on Interstate and Foreign Commerce, 73rd Congress, 2d Sess. 1934, p.115	32
F.S.A. § 517.21(1)	13, 31
Bloomenthal, Market-Makers, Manipulators and Shell Games, 45 St. John's L.Rev. 597 (1971)	29
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INDEX OF AUTHORITIES
(Continued)

	Page
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Rapp and Loeb, Tippee Liability and Rule 10b-5, U.Ill.L.Forum, Vol. 1971, No. 1, pp.55-90	29
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Ruder, Pitfalls in the Development of Corporate Securities Law Through Implication of Rule 10b-5, 59 Northwestern L.Rev. 185 (1964)	22

INDEX OF AUTHORITIES
(Continued)

	Page
Wettach, Securities Regulation—Rule 10b-5—A Federal Corporation Law?, 43 N.C.L.Rev. 637 (1965)	22
38 U.Chi.L.Rev. 337 (1971), Impact of Class Actions on Rule 10b-5	29
58 Northwestern L.Rev. No. 6 (1964), Shareholder Validation of Directors' Frauds: The Non-ratification Rule vs. The Business Judgment Rule	25
53 Harv.L.Rev. 1968 (1940)	25

NO. _____

Supreme Court of the United States

OCTOBER TERM, 1972

ROBERT R. FRANK, JACK H. STEIN, JOHN W. ROBERTS, JR., individually and as purported trustees under a Voting Trust Agreement, dated June 2, 1969, relating to the issued shares of INDUSTRIAL GUARANTY BANCORP, a Florida corporation, and INDUSTRIAL GUARANTY BANCORP, a Florida corporation,

Petitioners,

vs.

J. WILLIAM WOLF and PEARL M. WOLF, individually and derivatively for the shareholders of INDUSTRIAL GUARANTY BANCORP, a Florida corporation,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered on April 24, 1973.

CITATION TO OPINIONS BELOW

The United States District Court for the Southern District of Florida filed no opinion, but did enter its Findings of Fact and Conclusions of Law on March 27, 1972 [A. 64] and amendment thereto [A. 81]. It entered its Final Judgment on April 5, 1972 [A. 78].

The opinion of the Court of Appeals, which affirmed in part, reversed in part and remanded with instructions, dated April 24, 1973 [A. 1], is reported at 477 F.2d 467. The appellate court's denial of Petition for Rehearing and Petition for Rehearing En Banc is reported at ____ F.2d ____ [A. 29].

JURISDICTION

The judgment of the Court of Appeals (printed in the annexed Appendix [A. 25]), was entered on April 24, 1973. The Court of Appeals stayed its mandate to and including July 18, 1973 [A. 31], and further stayed its mandate to and including July 28, 1973 [A. 33]. The proceedings in the District Court had been superseded, the Petitioners having posted in accordance with court order a $600,000 supersedeas bond. Thus, the proceedings below have been stayed pending the filing of petition for writ of certiorari and final determination thereof by this Court.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

I.

THE PURPOSE OF THE SECURITIES ACT OF 1933,[1] THE SECURITIES EXCHANGE ACT OF 1934,[2] AND RULE 10b-5[3] WAS NOT TO GUARANTEE A PROFIT ON ILLEGAL SECURITY TRANSACTIONS TO A MARKET-MAKING DEALER WHO WAS AN INSIDER TIPSTER/TIPPEE IN CONNECTION WITH THE SALES OF SUCH SECURITIES.

II.

WHERE NO DIVERSITY OF CITIZENSHIP EXISTS AND THE AMOUNT IN CONTROVERSY IS BELOW THE JURISDICTIONAL LIMITS, AND THE PLAINTIFFS ELECT TO REJECT THE RELIEF AFFORDED BY THE FEDERAL STATUTES WHICH WERE ORIGINALLY USED TO INVOKE THE JURISDICTION OF THE FEDERAL COURT, A DISTRICT COURT MUST DISMISS THE MATTER SINCE IT IS DIVESTED OF JURISDICTION THEREOF.

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[1] **15 U.S.C. §§ 77a thru 77aa** [hereinafter referred to as the 1933 Act].

[2] **15 U.S.C. §§ 78a thru 78hh** [hereinafter referred to as the 1934 Act].

[3] Promulgated by the Securities and Exchange Commission, **17 CFR § 240.10b-5** [hereinafter referred to as SEC Rule 10b-5].

III.

NEITHER THE FEDERAL STATUTES NOR THE CONCEPT OF PENDENT JURISDICTION CREATES A BODY OF FEDERAL CORPORATION LAW, AND THEREFORE A DISTRICT COURT HAS NO JURISDICTION TO GRANT RELIEF UNDER SUCH A CONCEPT OF NONEXISTENT LAW, ESPECIALLY WHERE THE RELIEF GRANTED WAS NOT SOUGHT OR PRAYED FOR.

IV.

A DISTRICT COURT IN THE DISPOSITION OF ANY MATTER BEFORE IT IS REQUIRED BY LAW TO PRESERVE ITS INTEGRITY AND MUST RAISE SUA SPONTE THE DOCTRINE OF UNCLEAN HANDS AND/OR PARI DELICTO, TO PREVENT A SUITOR A RECOVERY WHERE HE HAS CONDUCTED HIMSELF IN SUCH A MANNER SO AS TO SHOCK THE MORAL SENSIBILITIES OF THE JUDGE.

V.

FEDERAL RULE OF CIVIL PROCEDURE 23.1[4] IS A RULE DEALING WITH A DISTRICT COURT'S JURISDICTION TO ENTERTAIN A DERIVATIVE ACTION, AND WHERE THE PARTIES SEEKING RELIEF HAVE FAILED TO PLEAD AND PROVE THAT THEY AS

[4]28 U.S.C., Rules of Civil Procedure.

PLAINTIFFS FAIRLY AND ADEQUATELY REPRESENT THE INTERESTS OF SHAREHOLDERS OR MEMBERS SIMILARLY SITUATED IN ENFORCING THE RIGHTS OF THE CORPORATION, THE ACTION MUST BE DISMISSED AS A MATTER OF LAW.

VI.

A DISTRICT COURT IS WITHOUT JURISDICTION TO GRANT RELIEF BEYOND THE LIMITATIONS EXPRESSED BY THE CONGRESS IN ITS ENACTMENT OF THE SECURITIES ACT OF 1933[5] AND THE SECURITIES EXCHANGE ACT OF 1934.[6]

VII.

A DISTRICT COURT'S JURISDICTION IS LIMITED BY THE SUBSTANTIVE PROVISIONS OF THE RESPECTIVE STATUTES OF LIMITATIONS ENACTED BY THE VARIOUS STATES[7] WHEREIN THE SAID COURTS PRESIDE.

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[5] 15 U.S.C. § 771.

[6] 15 U.S.C. § 78bb.

[7] 28 U.S.C. § 1652.

VIII.

THE CLEARLY ERRONEOUS DOCTRINE IN CONNECTION WITH APPELLATE REVIEW BY THE FEDERAL JUDICIARY IS NOT GOVERNED BY THE CONVICTION THAT THE WHOLE OF THE RECORD REFLECTS THE TRUTH AND RIGHT OF THE CASE, BUT UPON THE CONCEPT THAT WHEN THE ENTIRE RECORD AND EVIDENCE ARE READ THERE IS A CONVICTION THAT THE TRIAL COURT IN REACHING ITS RULING MADE A MISTAKE.

STATUTES, FEDERAL RULES OF CIVIL PROCEDURE, AND ADMINISTRATIVE REGULATIONS INVOLVED

Act of May 27, 1933, c. 38, Title I, § 5, 48 Stat. 77; June 6, 1934, c. 404, § 204, 48 Stat. 906; August 10, 1954, c. 667, Title I, § 7, 68 Stat. 684 [15 U.S.C. § 77e], provides:

> (a) Unless a registration statement is in effect as to security, it shall be unlawful for any person, directly or indirectly—
>
> (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or
>
> (2) to carry or cause to be carried through the mails or in interstate commerce, by any

means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this subchapter, unless such prospectus meets the requirements of section 77j of this title; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 77j of this title.

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportations or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 77h of this title.

Act of May 27, 1933, c. 38, Title I, § 12, 48 Stat. 84; August 10, 1954, c. 667, Title I, § 9, 68 Stat. 686 [15 U.S.C. § 77l] provides:

Any person who—

(1) offers or sells a security in violation of section 77e of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Act of June 6, 1934, c. 404, § 10, 48 Stat. 891 [15 U.S.C. § 78j] provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> (a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Act of June 6, 1934, c. 404, § 28, 48 Stat. 903 [15 U.S.C. § 78bb] provides:

> (a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this

chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.

(b) Nothing in this chapter shall be construed to modify existing law (1) with regard to the binding effect on any member of any exchange of any action taken by the authorities of such exchange to settle disputes between its members, or (2) with regard to the binding effect of such action on any person who has agreed to be bound thereby, or (3) with regard to the binding effect on any such member of any disciplinary action taken by the authorities of the exchange as a result of violation of any rule of the exchange, insofar as the action taken is not inconsistent with the provisions of this chapter or the rules and regulations thereunder.

Act of June 25, 1948, c. 646, 62 Stat. 944 [28 U.S.C. § 1652] provides:

The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.

Rule 23.1, Federal Rules of Civil Procedure, 28 U.S.C., provides:

DERIVATIVE ACTIONS BY SHAREHOLDERS

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.

Added Feb. 28, 1966, eff. July 1, 1966.

Rule 82, Federal Rules of Civil Procedure, 28 U.S.C. provides:

JURISDICTION AND VENUE UNAFFECTED

These rules shall not be construed to extend or limit the jurisdiction of the United States district courts or the venue of actions therein. An admirality or maritime claim within the meaning of Rule 9(h) shall not be treated as a civil action for the purposes of Title 28, U.S.C. §§ 1391-93.

As amended Dec. 29, 1948, eff. Oct. 20, 1949; Feb. 28, 1966, eff. July 1, 1966.

12 CFR § 221.4, Reg. § 221.4 of Regulation U, Federal Reserve System (Under § 7, Securities Exchange Act of 1934), provides:

Reg. § 221.4. Supplement. (a) *Maximum loan value of stocks.* For the purpose of § 221.1, the maximum loan value of any stock, whether or not registered on a national securities exchange, shall be 35 percent of its current market value, as determined by any reasonable method. [As amended effective June 8, 1968, 33 F. R. 8772; effective July 8, 1969, 34 F. R. 9207]

17 CFR § 240.10b-5 (1949) [SEC Rule 10b-5] provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instru-

mentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud.

(b) To make any untrue statement or a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

F.S.A. § 517.21 provides:

(1) Every sale made in violation of any of the provisions of this chapter shall be voidable at the election of the purchaser; and the person making such sale and every director, officer or agent of or for the seller, if the director, officer or agent shall have personally participated or aided in any way in making the sale, shall be jointly and severally liable to the purchaser in an action at law in any court of competent jurisdiction upon tender of the securities sold or of the contract made, for the full amount paid by such purchaser, with interest, together with all taxable court costs and reasonable attorney's fees; provided, that no action shall be brought

for the recovery of the purchase price after two years from the date of such sale and provided further, that no purchaser otherwise entitled shall claim or have the benefit of this section who shall have refused or failed within thirty days from the date thereof to accept an offer in writing of the seller to take back the security in question and to refund the full amount paid by such purchaser, together with interest on such amount for the period from the date of payment by such purchaser down to the date of repayment, such interest to be computed:

(a) In case such securities consist of interest bearing obligations at the same rate as provided in such obligations; and

(b) In case such securities consist of other than interest bearing obligations at the rate of six per cent per annum; less, in every case, the amount of any income from said securities that may have been received by such purchaser.

(2) Any person having a right of action against a dealer or salesman under this section shall have a right of action under the bond provided in § 517.12.

STATEMENT

A. PROCEEDINGS IN THE TRIAL COURT

The parties will be referred to in their original capacity in the trial court.

The Plaintiffs below, J. WILLIAM WOLF and PEARL M. WOLF, husband and wife, must be considered as one individual party holding a common status as joint venturers in connection with the matters and things material to these proceedings,[8] and they in fact acted solely and exclusively through the husband, J. WILLIAM WOLF.

Mr. Wolf, a registered real estate broker, a onetime bank director, and a securities investor, some time in the middle of 1969 received a tip in connection with the organization of a bank holding company. The tip emanated from the Defendant STEIN. WOLF subsequently confirmed the tip through conversations with the Defendants, FRANK and ROBERTS.

The bank holding company was to be organized under the laws of the State of Florida and was to be limited to fifteen stockholders, all residents of the State of Florida, to wit, INDUSTRIAL GUARANTY BANCORP [hereinafter referred to as IGB]. The organizers intended to exempt the IGB securities.[9]

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[8]Paragraph 5 of the Second Amended Complaint alleges: "At all material times, plaintiff J. William Wolf was the agent of Pearl M. Wolf who was then his wife, acting within the scope of his authority." [A.] The evidence adduced before the District Court clearly shows that all purchases of securities involved in these proceedings emanated from a joint account maintained in the names of both Mr. and Mrs. Wolf. The original deposit in said account was the proceeds of a loan of $50,000 from a New Jersey bank. The evidence further reflected that all profits realized from the sale of the securities involved were deposited into said account, and all payments for purchases of the securities involved were made by withdrawals from this account.

[9]Exempt from registration under the Securities Act of 1933, 15 U.S.C. § 77c.

At this time WOLF maintained two residences, one in Broward County, Florida and one in New Jersey. During his discussions he left the impression with the Defendants that he was a Florida resident. In any event, he subscribed to the purchase of 37,500 shares at $2 per share directly from IGB. He did not pay for the subscription at that time, instead WOLF immediately commenced selling portions of it to third parties at prices in excess of $2 per share. In the early part of July 1969 the proceeds of such sales were deposited into a bank account maintained in the name of Plaintiff PEARL M. WOLF. In July 1969 both Plaintiffs borrowed $50,000 from a New Jersey bank[10] and deposited the loan proceeds into the joint bank account.

In the latter part of July 1969, WOLF forwarded the loan proceeds [$50,000] to IGB in payment of 25,000 shares of IGB stock. He made no indication of his resale of portions of his holdings and the entire 25,000 shares were registered in his name. WOLF continued to sell his IGB stock at prices in excess of $2 per share but did not advise IGB to reissue any shares in the names of his buyers.

In September 1969, WOLF forwarded an additional $12,500 to IGB in payment for 6,250 shares at $2 per share, and WOLF continued his sales of IGB stock.

On or about September 19, 1969, the individual Petitioners, with the consent or a majority of the Board of Directors of IGB, and 99% of its stockholders, exchanged their individual stock holdings in a national bank located

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[10]No compliance with Regulation U of the Federal Reserve Board. 12 C.F.R. 221.4, p. 12, *supra*.

in Miami, Florida, to wit: National Industrial Bank for IGB stock.

In October 1969 WOLF forwarded an additional $12,500 to IGB to pay for 6,250 shares at $2 per share. IGB, in accordace with WOLF's instructions, registered the September and October purchases either in WOLF's name or in MRS. WOLF's name.

IGB failed to obtain the hoped for exemption in accordance with the Act of 1933.[11]

On February 18, 1971 the proceedings in the trial court were commenced. An unverified Second Amended Complaint was filed on July 1, 1971 [A. 36], in three counts.

Count I charged IGB with misrepresentations, omissions, manipulative and deceptive devices, and the contrivance of a scheme and artifice to defraud the Respondents, in contravention of § 10(b) of the Act of 1934[12] and Rule 10b-5 promulgated and adopted by the Securities and Exchange Commission of the United States[13] [A. 47].

Count II charged IGB with violation of § 5 of the Act of 1933,[14] since IGB failed to register the securities with the SEC as required by § 5 of the 1933 Act.[15] [A. 47].

[11]Note 9, *supra*.

[12]15 U.S.C. § 78j(b), pg. 9, *supra*.

[13]Note 3, pg. 12, *supra*.

[14]15 U.S.C. § 77e; Note 8, pg. 6, *supra*.

[15]15 U.S.C. § 77e; Note 8, pg. 6, *supra*.

Count III charged that as a result of the fraudulent representations and omissions and acts of the corporate and individual Defendants, the Plaintiffs were damaged individually and derivatively, for a sum in excess of $10,000. Included in this particular Count was a charge of an intentional omission and false representation, attributable to the corporate and individual Defendants, to induce the Plaintiffs to purchase IGB stock [A. 48].

The Plaintiffs sought equitable relief, i.e., a preliminary and permanent injunction, the appointment of a receiver, an accounting, the imposition of a trust, and the impressment of an equitable lien, in order to secure any sums that may be due and owing to the Plaintiffs individually and derivatively. Further, the Plaintiffs sought the assessment of a sum in excess of $10,000 for compensatory damages, either individually or derivatively, as well as such other and further relief as may be deemed proper [A. 49].

The corporate and individual Defendants answered the Second Amended Complaint with general denials and affirmative defenses, which included allegations that the Plaintiffs resold their IGB stock at substantial profits, that the Plaintiffs suffered no loss, were in pari delicto and with unclean hands, and that the purpose of the lawsuit was to diminish the Plaintiffs' exposure to oral guarantees they had made to their customers who purchased IGB stock at prices higher than $2 per share; that the action was barred by the statute of limitations, and that the said Plaintiffs had not properly tendered for recission the IGB stock they still held, as required by the Act of 1933.[16] [A. 50]

[16]Note 5, pg. 8, *supra*.

The Defendants filed a Motion for Judgment on the Pleadings [A. 52], which the court treated as a motion for summary judgment, and dismissed the individual claim under § 12 of the Act of 1933.[17] The court further denied any derivative relief under the 1933 Act [A. 54].

The summary judgment did not disturb the Plaintiffs' individual claims under § 10 of the Act of 1934 and SEC Rule 10b-5.

On February 18, 1972 Plaintiffs filed an Amendment to the Second Amended Complaint by adding paragraph 32 to the **addendum clause** in which they sought and prayed for rescission of their purchase, i.e., to exchange the certificates still held for the purchase price paid therefor. [A. 59]

On March 8, 1972, the Defendant IGB filed its answer to the Amendment to Second Amended Complaint, and accepted the offer of rescission and tendered into the registry of the Court a $28,000 cashier's check made payable to the Clerk of the Court, representing the purchase price of the 14,000 shares still held by the Plaintiffs. [A. 60].

Trial was held before the Honorable C. Clyde Atkins, District Judge, without a jury. At the conclusion of the Plaintiffs' case the Plaintiffs' individual § 10 and 10b-5 claims were dismissed since they failed to show any actual damage.

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[17]Note 15, *supra*.

The court without any record to support it found that the § 10 and 10b-5 was properly filed.

The findings of the trial court are of interest since the court found as a matter of fact that the Plaintiffs violated the Act of 1933, and that they in fact had profited from said violations. [A. 54, 64, 67 and 82].

The court went on to find that the Plaintiffs established a derivative cause of action against the three individual Defendants in connection with the September 19, 1969 exchange of IGB stock for National Industrial Bank stock, and that there was no need to route the recovery to the minority shareholders. [A. 74][18]

The court denied punitive damages and intimated that the 10b-5 relief remedied the "state law claims"; and further ruled that the Plaintiffs could recover the $28,000 reposing in the Registry of the Court, if they so elected to rescind their purchase [15 U.S.C. § 771 and 15 U.S.C. 78bb, pg. 8 and 9].

On March 29, 1972 the Plaintiffs renounced their right to rescission [A. 77].

On April 5, 1972, Final Judgment was entered, awarding IGB (derivative Defendant/Plaintiff below) the

[18]Neither of the lower courts answered the riddle of the lack of jurisdiction. It was apparent early in the proceedings that the Plaintiffs could not recover individually in excess of $10,000 [compare their stock holdings of .0093% on a pro rata basis with the total derivative recovery]. As a matter of law they were not entitled to rescission since they had in fact profited. When the trial court seized upon the granting of relief in the nonprayed for diversity situation, the proper alignment of the parties plaintiff and defendant would have defeated the court's jurisdiction for lack of diversity [IGB, a Florida corporation, would have to be regarded as a plaintiff, see note 21, *infra*].

following recoveries from the Respondents, STEIN — $248,072.11; FRANK — $138,921.64; ROBERTS — $109,151.90.

In disposing of the Defendants' post-trial motions, the trial court denied Defendants' Motion for new trial, but granted Defendants' motion to amend the Findings of Fact and Conclusions of Law [A. 81]. Supersedeas was posted, and an appeal was prosecuted to the United States Court of Appeals for the Fifth Circuit.

B. PROCEEDINGS IN THE COURT OF APPEALS.

On April 24, 1973, the United States Court of Appeals for the Fifth Circuit entered its opinion, reported at 477 F.2d 467 [A. 1], and its judgment [A. 25], which affirmed in part and reversed in part the judgment of the District Court.

On May 16, 1973, the Court of Appeals disposed of some pending matters, including denial of reimbursement of costs sought by the Petitioners herein; denial of an allowance to Respondents' attorneys for reasonable fees in conjunction with some interlocutory matters lately pending in the Court of Appeals; however, it did direct the District Court to determine an amount of attorneys' fees incurred by the Respondents in prosecuting and defending the appeal and cross-appeal, as well as an allowance of expert witness fees and attorneys' fees in maintaining the derivative suit. [A. 27] All of said awards were to be disbursed by IGB [A. 28].

The court of appeals stayed it's mandate to July 28, 1973 [A. 3[illegible]].

REASONS FOR GRANTING THE WRIT

It is evident that the federal judiciary has been called upon from time to time to invoke its jurisdiction in time-consuming class and derivative actions involving security transactions. In these instances there has been a constant expansion of federal jurisdiction to areas never intended to be covered by the Congress when the Acts of 1933 and 1934 were enacted.

The various Circuit Courts of Appeals have approved this unwarranted extension of federal jurisdiction to such a degree that it has become a contributing factor to further burden an already overburdened judicial system. However, the legal announcements in this extension of jurisdiction have resulted in conflicting and confusing legal concepts which have created contentions amongst the Circuit Courts of Appeals, as well as dissensions within the circuits.

There have been no definite or concise guidelines pronounced by this Court through the exercise of its supervisory jurisdiction to limit this unwarranted extension of jurisdiction by the trial and intermediary federal courts. The encroachment by the federal judiciary into the area of corporate activities has given much concern as to whether or not the federal judiciary, in its efforts to extend its jurisdiction, has enacted through opinion a body of federal corporation law.[19]

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[19]*See* Ruder, Pitfalls in the Development of Corporate Securities Law Through Implication of Rule 10b-5, **59 Northwestern L.Rev.** 185 (1964); Wettach, Securities Regulation—Rule 10b-5—A Federal Corporation Law?, **43 N.C.L.Rev. 637** (1965). It must be conceded that during the past eight

The extension of this jurisdiction is in fact an usurpation of the jurisdiction of the courts of the respective states, since they afford adequate and complete relief in most if not all of the matters involved in connection with the great body of corporation law. However, the continued usurpation of jurisdiction by the federal trial courts, condoned by the various Circuit Courts of Appeals, has extended to areas which were never in the contemplation of the Congressional purport and intent expressed in the Acts of 1933 and 1934, and the rules promulgated in accordance therewith by the SEC.

The case at bar is a typical example of condonation by the Fifth Circuit Court of Appeals of the unauthorized extension of federal jurisdiction by a district trial court. An extension which is in direct contravention of the legislative intendment of the statutes and rules involved. The approval contained in the opinion of the Fifth Circuit in question further exemplifies the appellate condonation of the unwarranted extension of federal jurisdiction by the utilization of generalities in the disposition of important issues without recognizing the inherent evil in the procedure, or without recognizing the true and concrete issues raised by the record below.

Therefore, this instant application for the writ of certiorari, in addition to calling to this Honorable Court's

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years the degree of erosion by the federal judiciary in the area of corporation law has been accelerated rather than limited.

Fleischer, Federal Corporation Law: An Assessment, **78 Harv.L.Rev. 1146** (1965); Ruder, Corporate Disclosures by the Federal Securities Laws: The Codification Implications of Texas Gulf Sulphur, **61 Northwestern L. Rev. 1967,** No. 6, article based upon a talk delivered at the Fifth Annual Corporation Counsel Institute held at Northwestern University School of Law October 13 and 14, 1966.

attention the conflicts created by the opinion in question, prays that there be an exercise of the supervisory jurisdiction of this Court to establish guideposts to readvise the federal judiciary that the trial courts are courts of limited jurisdiction which is to be invoked within the confines of the Constitution, the Treaties, and the Laws of the United States.

I.

Federal corporation law does not exist as a body of law which creates jurisdiction in the federal courts, and it cannot be utilized by a federal court to retain jurisdiction over a nonfederal claim in an attempt to correct a wrong. Thus, the opinion of the Fifth Circuit is an effort to condone this unwarranted jurisdiction by the trial court, and runs afoul of the pronouncements of this Court, and creates additional conflict between its sister circuits.[20]

The opinion under consideration is in direct contravention of the clearly enunciated doctrine of this Court, *see* **Hurn v. Oursler,** 289 U.S. 238, 53 S.Ct. 586, 589, 77 L.Ed. 1148 (1933); **Armstrong Paint & Varnish Co. v. Nu-Enamel Corp.,** 305 U.S. 315, 59 S.Ct. 191, 83 L.Ed. 195, *rehearing denied* 305 U.S. 675, 59 S.Ct. 356, 83 L.Ed. 437.

The decision is in conflict with the Fourth Circuit Court of Appeals, *see* **Rumbaugh v. Winifrede Railroad**

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[20]Where an individual cause of action seeks injunctive, accounting and receivership relief, it creates a conflict of interest so deep that such plaintiff cannot be afforded derivative relief, for the sought after individual primary relief precludes the maintaining of the suit to recover secondary rights. [**Zahn v. Transamerica Corporation** (CA3 1947) 162 F.2d 106; note 21, *infra*.]

Co. (CA 4 1964) 331 F.2d 530, *cert. denied* 379 U.S. 923, 85 S.Ct. 322, 13 L.Ed.2d 341 (1964).[21]

However, the insistence of the trial court to apply federal corporation law with the approval of the opinion under consideration leads to a conflict between the Fifth Circuit with its sister courts in the Second, Third, Ninth and Tenth Circuits. *See* **Popkin v. Bishop** (CA2 1972) 464 F.2d 714; **Knauff v. Utah Construction & Mining Co.** (CA10 1969) 408 F.2d 958; **DePova v. Camden Forge Co.** (CA3 1958) 254 F.2d 248.[22]

The opinion under consideration overlooks this Court's strong directive in **Superintendent of Insurance v. Bankers Life & Casualty,** 404 U.S. 6, 12, 92 S.Ct. 165, 30 L.Ed.2d 128 (1971).[23]

We are once again reminded that the Fifth Circuit failed to recognize that before a federal court could retain a matter, the federal claim must have substance sufficient to confer subject matter jurisdiction on the court, and once it appears that only a state law cause of action exists and it constitutes the real body of the case to which

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[21]See **3B Moore's Federal Practice,** ¶ 23.1.16, pp. 23.1-101 thru 106, and Annotation at **5 ALR3d 1060-1062,** and cases cited therein.

[22]See also **Lanning v. Sherwood** (CA9 1973) 474 F.2d 716, 719; **5 Fletcher Cyc.Corp. § 2143.1** (Perm.Ed. 1967);

See a'so Shareholder Validation of Directors' Frauds: the Nonratification Rule vs. The Business Judgment Rule, **58 Northwestern L.Rev. No. 6** (1964); Landstrom, Ratification by Majority of Stockholders: A Problem in Corporate Democracy, **31 BUL L.Rev. 165** (1951); see also Note, **53 Harv. L.Rev. 1368** (1940).

[23]We agree that Congress § 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement." **404 U.S. at 12.**

a federal claim is only an appendage, the cause of action must be dismissed by the federal court and relegated to the state tribunals. **United Mine Workers v. Gibbs**, 383 U.S. 715, 725, 727, 86 S.Ct. 1130, 16 L.Ed.2d 218 (1966).

II.

The federal judiciary must invoke its jurisdiction to carry out the Congressional intent[24] within an atmosphere to sanctify its integrity and protect its honor to a degree which requires it to deny relief, *sua sponte* if necessary, to any wrongdoer.

This Court enunciated a doctrine which required the denial to a wrongdoer [Plaintiff—unclean hands], sua sponte if necessary, of any relief. [**Keystone Driller Co. v. General Excavator Co.**, 290 U.S. 240, 54 S.Ct. 146, 78 L.Ed. 293 (1933); **Morton Salt Co. v. Suppiger Co.**, 314 U.S. 488, 62 S.Ct. 402, 86 L.Ed. 363 (1942). **Precision Instrument Mfg. Co. v. Automative Maintenance Mach. Co.**, 324 U.S. 806, 65 S.Ct. 993, 89 L.Ed. 1381, (1945)].

The proceedings at bar were bottomed in equity [A. 58]. The lower federal courts dispensing equitable relief are required on their own to investigate the acts and conducts of a party plaintiff who seeks to set this judicial machinery in motion. These courts are required to ascertain that there was no violation of good conscience,

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[24]The Acts of 1933 and 1934 were never intended by Congress to permit a wrongdoer—in violation of the statutes, the rules of the SEC and the regulations promulgated by the Federal Reserve Board [**Regulation U** *(12 CFR §221.4)*], where such wrongdoer at the commencement of the original suit had recovered his original investment and realized a profit of $22,550, in addition to the retention of 14,000 shares of the security he wrongfully dealt in—to invoke the jurisdiction of the federal courts to guarantee a retention of such profits without accounting therefor.

good faith, or any other equitable conduct, by the plaintiff by his pre-suit acts; for if he acted with unclean hands and in fact violated the tenets of the statute under which he sought relief, the doors of the federal courts will be shut against him in limine.

Therefore, the opinion under consideration has refused to recognize this basic sua sponte investigation by a federal trial court to determine whether or not there should be a denial of relief because the acting Plaintiff did in fact violate the intent of the Congress as expressed in the statutes involved. The acts in question need not be unlawful, they need only be unconscionable or contrary to good morals. Thus, where the legislation condemns conduct of a party seeking relief in accordance with the statutory dictates, the courts are required to deny such wrongdoer any judicial determination. [**J. I. Case v. Borak**, 377 U.S. 26, 433, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964).]

In fairness to the situation, we remind the Court that in a recent anti-trust case[25] it announced a doctrine which precludes the raising of a defense of pari delicto in litigation involving violations of the anti-trust laws of the United States. This enunciation lead, either correctly or erroneously, to a recent decision in the Second Circuit Court of Appeals which expanded the nonavailability of a pari delicto defense to litigation involving violations of the Acts of 1933 and 1934 and the rules promulgated thereunder by the SEC. [**Pearlstein v. Scudder and German** (CA2 1970) 420 F.2d 1136, 1141.]

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[25]**Perma Life Mufflers v. Intern. Parts Corp.**, 392 U.S. 134, 88 S.Ct. 1981, 20 L.Ed.2d 982 (1968).

Yet, overlooked in the rush to accept the nonavailability of pari delicto and unclean hands defenses in securities litigation, is the enunciation of this Court that *pari delicto* and unclean hands should be recognized *sua sponte* in copyright, patent and trademark litigation. [*Keystone Driller Co. v. General Excavator Co., supra; Morton Salt Co. v. G. S. Suppiger Co., supra.*]

The availability of the defenses of *pari delicto* and unclean hands to one body of the law, and their unavailability in another body of the law, has created a divergence of decisions amongst the sister Circuit Courts of Appeals which has compounded the confusion. Finally, in at least one circuit, the denial of a defense of *pari delicto* in securities law has not been universal, thus creating a conflict within that particular circuit, *compare*, Serzysko, *infra*, with Pearlstein, *supra*.

We beg the Court's indulgence to examine the opinion under question, which deems unclean hands and *pari delicto* —even though the integrity and honesty of the court is involved—to be a discretionary matter, with the following decisions enunciated in the sister circuits, which stand in direct conflict with the opinion under consideration. In the Second Circuit, *see* **Serzysko v. Chase Manhattan Bank** (CA2 1969) 409 F.2d 1360, *affirming* **Serzysko v. Chase Manhattan Bank** (SDNY 1968) 290 F.Supp. 74; **Crane Co. v. Westinghouse Air Brake Co.** (CA2 1969) 419 F.2d 787, 793; **SEC v. Texas Gulf Sulphur** (CA2 1968) 401 F.2d 833, 858, 860, *cert. denied sub nom*, **Coates v. SEC**, 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed.2d 756 (1969). In the Third Circuit, *see* **Monsanto Co. v. Rohm & Haas Co.** (CA3 1972) 456 F.2d 592; **Gaudiosi v. Mellon** (CA3 1959) 269 F.2d 873,

882.[26] In the Seventh Circuit, *see* **Feist v. Young** (CA7 1943) 138 F.2d 972; in the Eighth Circuit, *see* **Earle R. Hanson & Assoc. v. Farmers Coop. Creamery Co.** (CA8 1968) 403 F.2d 65, 70. In the Ninth Circuit *see* **West Los Angeles Institute for Cancer Research v. Mayer** (CA9 1966) 366 F.2d 220, 227; **Republic Molding v. B. W. Photo Utilities** (CA9 1963) 319 F.2d 347, 350, and with **Kuehnert v. Texstar Corp.** (CA5 1969) 412 F.2d 700.

The modern text writers urge that permitting redress to a wrongdoer in securities litigation, in contravention of the Congressional intent and purpose of the Act, is indeed a sacrilege. They almost universally urge that it was the intent of Congress to force a profiteer to disgorge his profits prior to allowing relief.[27]

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[26]Judge Kalodner appeared firmly convinced that the unclean hands doctrine adversely affecting a plaintiff should require dismissal of a derivative stockholders suit, observing that justice may be blind, but it is not dumb.

[27]Bloomenthal, From Birnbaum to Schoenbaum: The Exchange Act and Self Aggrandizement, 15 N.Y.Law Forum 332 (1969); DeLancey, Rule 10b-5—A Recent Profile, 25 Business Lawyer 1355 (July 1970); The Impact of Class Actions on Rule 10b-5, 38 U.Chi.L.Rev. 337 (1971); Rapp and Loeb, Tippee Liability and Rule 10b-5, U.Ill.L.Forum, Vol. 1971, No. 1, pp. 55-90. [Messrs. Rapp and Loeb conclude that ". . . when tippees have the same knowledge as insiders, there is little difference between their relative culpability and potential for harm. Arguably the same arsenal of remedies that can be invoked against insiders should be available to deter and punish tippees and to compensate their victims. They should be enjoined, disciplined by the SEC, subjected to criminal sanctions, and made to pay actual and, if appropriate, punitive damages to injured persons. . . ." ". . . If the courts are willing to impose so severe a sanction on insiders, then the same sanctions should be imposed on tippees, when their knowledge makes them equally culpable." (at p. 88)] The Respondents here were both insiders and tippees. *See also* Fosshay, Market Activities of Participants in Securities Distributions, 45 Va.L.Rev. 907 (1959); Bloomenthal. Market-Makers, Manipulators and Shell Games, 45 St. John's L.Rev. 597 (1971); Jennings, Insider Trading in Corporate Securities: A Survey of Hazards and Disclosure Obligations Under Rule 10b-5, 62 Northwestern L.Rev., No. 6 (1968), from a

III.

This Court has never made a clear expression as to the operative effect of Federal Rule of Civil Procedure 23.1. The question as to whether or not its provisions are mandatory and must be complied with both in pleading and proof by any party seeking derivative relief from the federal judiciary remains unanswered. The rule is direct, clear and concise. Yet it has been made the operative force to extend and expand the jurisdiction of the federal courts, in contravention of the clear edict enunciated in Federal Rule of Civil Procedure 82.

When Rule 23.1 was promulgated, it did not—as its predecessor, former Rule 23(b)—seek to divest state courts of their jurisdiction to try charges of corporate mismanagement and grant minority dissident stockholders relief. The rule itself was not intended to broaden and widen the jurisdiction of the federal courts.

The opinion below is in direct conflict with a recent decision of the Sixth Circuit Court of Appeals; *see* **Nolen v. Shaw-Walker Co.** (CA6 1971) 449 F.2d 506, 508. The **Nolen** decision cannot be reconciled with the opinion below.

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paper delivered at the Sixth Annual Corporation Counsel Institute held at Northwestern University School of Law October 13 and 14, 1967.

See also opinion of Circuit Judge Friendly in **Katz v. Amos Treat Co.** (CA2 1969 411 F.2d 1046, 1054; see also **Mott v. Tri-Continental Financial Corp.** (CA2 1964) 330 F.2d 468, 471; **Straley v. Universal Uranium and Milling Corp.** (CA9 1961) 289 F.2d 370, 373; and one should not overlook this Court's admonition in **Deckert v. Independence Shares Corp.**, 311 U.S. 282, 287-288 (1940).

We ask ourselves what disposition the Sixth Circuit would have made of the case at bar since the Respondents failed to verify their complaint, and failed to allege that they fairly and adequately represented the interests of shareholders or members similarly situated in enforcing the rights of the corporation. This latter omission, compounded by a complete lack of proof of unanimity of fairly and adequately representing the interests of others similarly situated, in the light of the percentile of stock held by the Respondents, would no doubt have resulted in the Sixth Circuit denying any and all relief to the said Respondents, without reaching the question of clean hands and pari delicto, sua sponte or otherwise.

IV.

The opinion below fails to recognize that a federal trial court is governed by the substantive provisions of the state statutes, and in violating this mandate the opinion below runs afoul of the law of the State of Florida as well as the enunciations of this Court.

Again we find deep dissidence since the opinion under consideration refuses to accept the statutory dictates and this Court's rulings. Florida statute of limitations[28] involved in causes of action instituted to recover considerations paid or received in connection with securities frauds, requires as a condition precedent to maintaining the action within a two-year period the tendering of the securities in exchange for the consideration. The statute contains limitations of recovery similar to those limitations of recovery set forth in the Acts of 1933 and 1934.[29]

[28] **F.S.A. § 517.21(1)**, pg. 18, *supra*.

[29] See **15 U.S.C. §§ 771, 78bb, and F.S.A. § 517.21**, pp. 8, 9 and 18, *supra*.

In contravention of this Court's ruling in Reading Co. v. Koons, 271 U.S. 58, 46 S.Ct. 405, 406, 70 L.Ed. 835 (1936) the opinion under consideration regards a state statute of limitations controlling only as to those "chronometric aspects." Thus, we find a disregard for the rules of decision legislation which limits the federal judiciary's jurisdiction.[30]

V.

The Congressional intendment as expressed in the Acts of 1933 and 1934 were basically remunerative in their remedial aspects [**Herpich v. Wallace** (CA5 1970) 430 F.2d 792, 804]. Thus, the opinion under consideration once again runs afoul of the Congressional intention, since it bestows upon a federal trial court jurisdiction to grant relief beyond the Congressional limitation. The Respondents below were more than whole at the time of the commencement of the proceedings in connection with their investment. In fact, if they were required to account, they could not be classified as stockholders, since the 14,000 shares of IGB that they held at the time of the commencement of the proceedings represented no financial investment on their part. In addition thereto, they had realized some $21,550 profit.

It was never the Congressional intention by the enactment of the legislation under consideration to grant a right of action to parties allegedly aggrieved hereunder to be guaranteed a profit and be permitted to maintain a lawsuit in furtherance of obtaining additional profits. [See Hearings on Stock Exchange Regulations before the

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[30]Note 7 *supra*, pg. 10, *supra*.

House Committee on Interstate and Foreign Commerce, 73rd Congress, 2d Sess. 1934, p. 115; 3 **Loss, Security Regulation** 1424 (2nd Ed. 1961); Sec. Exch. Act Rel. No. 3230 (5-21-42), 8 **SEC Ann. Rep.** 10 (1943.]

Yet the opinion below would permit a substantial wrongdoer, in violation of the legislation he seeks to invoke for his remedy, not only to retain his profit, but to prosecute a cause of action to further benefit from his wrongdoing.

To recognize such proceedings under the Acts of 1933 and 1934 would be such a severe departure from the Congressional intention that it in fact would mark the return to an era of stockholder "strike" suits maintained through manipulative chicanery.

VI.

The opinion below is in conflict with this Court's direction governing a reviewing court's application of the clearly erroneous doctrine. The decision below seeks to invoke a concept of the truth and right of the case in the review of the entire record, rather than the required concept that a reviewing court in examining the record and the inferences drawn therefrom, if convinced that a mistake has been committed, is then required to set aside the judgment of the trial court. Thus, the decision below is in conflict with this Court's mandate; see **United States v. United States Gypsum Co.**, 333 U.S. 364, 395, 68 S.Ct. 525, 92 L.E.d. 746 (1948).

The opinion's refusal to follow the foregoing mandate of this Court creates a conflict with the status of the law in the Sixth Circuit in Texas Continental Life Ins. v. Dunne (CA6 1962) 307 F.2d 249.

The basic mistake made by the trial court was that it failed to recognize *sua sponte* the inequitable position of the Respondents, their failure to plead and prove that they fairly and adequately represented members of a class similarly situated; and finally, that more than ninety-nine per cent of the stockholders, as well as all of the directors of IGB, approved the September 19, 1969 transaction which was made the basis of the derivative recovery.[31]

It is therefore clear that the misapplication of the clearly erroneous doctrine by the reviewing court prevented the court from examining the record to make a determination in connection with the basic mistake or mistakes committed by the trial court, and again shows a conflict with the opinions of this Court, as well as those of the Sixth Circuit.

[31]No additional amplification need be had in connection with lack of jurisdiction, nondiversity, insufficiency of amount in controversy, and the conflict between the primary recovery in direct opposition to the secondary derivative recovery.

CONCLUSION

For the reasons aforesaid, which present substantial issues, raising questions of jurisdiction and the application of this Court's supervisory jurisdiction, it is respectfully prayed that a writ of certiorari be granted to review the judgment of the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,

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